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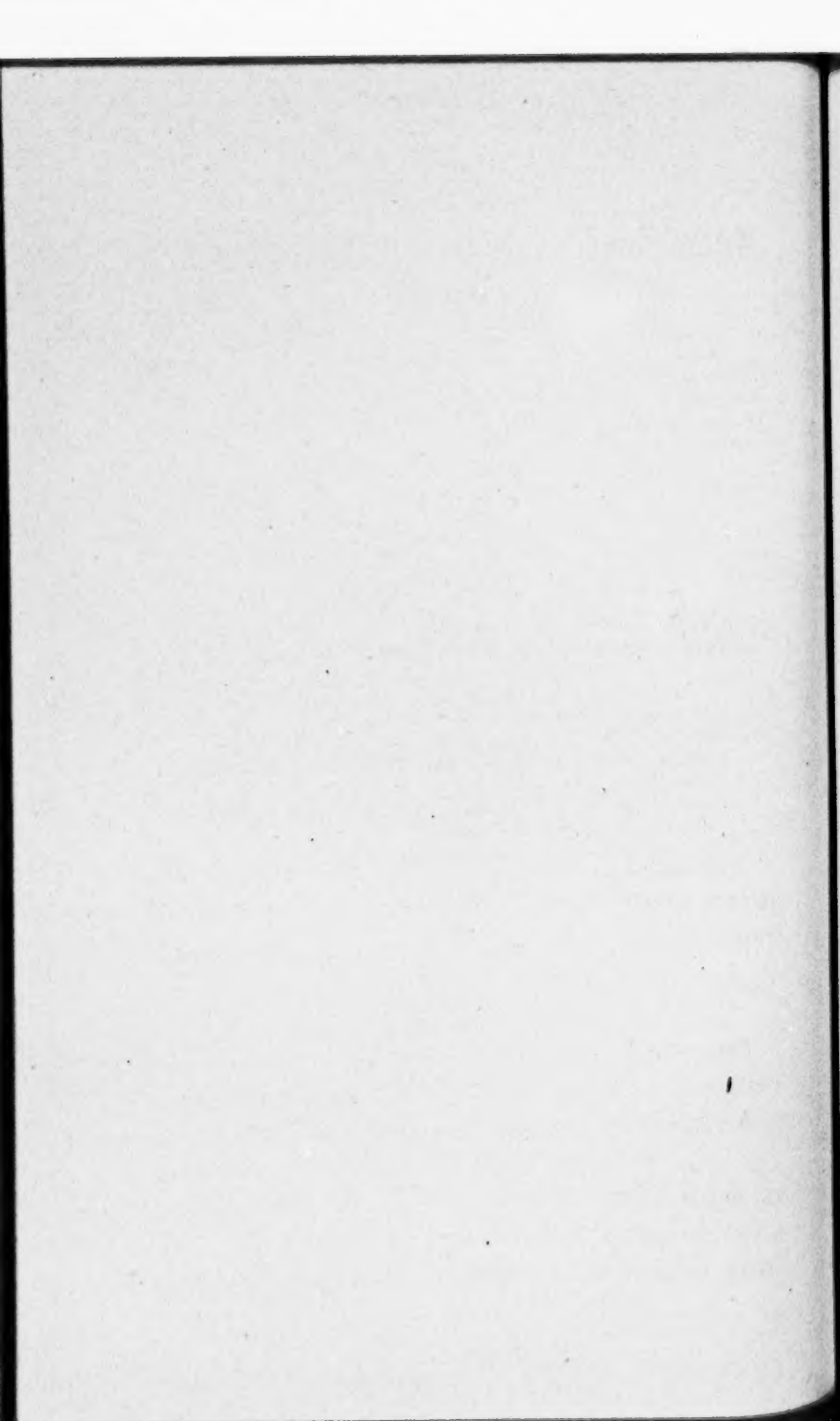
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In the Supreme Court of the United States

OCTOBER TERM, 1945

No. 912

PAUL H. SMART, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The opinion of the Tax Court (R. 18-23) is reported in 4 T. C. 846. The opinion of the Circuit Court of Appeals (R. 81-85) is reported in 152 F. 2d 333.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered on December 6, 1945. (R. 86-87.) Rehearing was denied on December 21, 1945. (R. 93.) Petition for a writ of certiorari was filed March 5, 1946. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Whether the "principal" commissions awarded to a New Jersey testamentary trustee in 1941 are taxable under the special provisions of Section 107 of the Internal Revenue Code as amended by Section 139 of the Revenue Act of 1942.

STATUTES INVOLVED

The pertinent statutes are printed in the Appendix, *infra*, pp. 10-12.

STATEMENT

The relevant facts as stipulated (R. 47-49) and as found by the Tax Court (R. 11-18) are as follows:

The taxpayer, a New York attorney, and Josiah Macy Willets were named as trustees of the residuary trust under the will of Walter G. Ladd, who died on May 21, 1933, and whose will was probated in the Prerogative Court of the State of New Jersey on June 1, 1933. They acted jointly from May 21, 1933, to the date of the death of Willets on October 7, 1940. (R. 11, 47.)

The trust comprised two substantial pieces of real property, one in Short Hills, New Jersey, and one at Bar Harbor, Maine, and personal property valued at approximately \$10,000,000. (R. 11.)

The decedent directed the trustees to maintain the real property during the lifetime of his widow in the same manner in which it had been maintained by him and to pay the income from his

personal property to her. Upon the death of the widow, the trustees were directed to transfer the entire estate, both real and personal, less five charitable legacies, to a charitable corporation for the purpose of maintaining the real property as a home for deserving gentlewomen who were without funds and who needed rest, hospitalization and similar charitable attention. Income in excess of the requirements for maintaining the home was to be used in aiding persons recuperating from the effects of illness or impaired health. The balance of income, if any, was to be distributed to and among hospitals, medical schools and other educational institutions. The ultimate beneficiaries of the principal, both real and personal, were two hospitals and three schools. (R.11-12.)

Prior to December 28, 1937, the taxpayer and his co-trustee filed a "First Intermediate Account" in the New Jersey Prerogative Court, after which the court issued a decree ordering, among other things, that (R. 13)—

said accountants be allowed and paid out of the aforesaid balance of income the sum of \$58,836.64, as and for their commissions, being at the rate of 5% on \$1,176,732.75 income collected * * *.

After Willets' death and during November, 1941, taxpayer as surviving trustee and Fidelity Union Trust Company, as substituted trustee, filed a "Second Intermediate Account." In this account, in addition to an application for com-

missions on income at the rate of five per cent, an application was also made by taxpayer and the representative of the deceased trustee for the allowance of one and one-half per cent commissions on the corpus of the trust for the services rendered by taxpayer and Willets from May 21, 1933, to October 7, 1940. (R. 13-14.) On December 9, 1941, the court issued a decree which is in part as follows (R. 14-15):

It is further ORDERED that there be allowed to Paul Smart and Gladys B. Willets, administratrix of the estate of Josiah Macy Willets, deceased trustee, the sum of * * * (\$146,395.87) as commissions on corpus for services rendered by Paul Smart and Josiah Macy Willets from May 21, 1933, the date on which said trust was set up until October 7, 1940, said allowance to be paid by Paul Smart and Fidelity Union Trust Company out of the foregoing balance of principal;

It is further ORDERED that there be allowed to Paul Smart and Gladys B. Willets, administratrix of the estate of Josiah Macy Willets, deceased, the sum of * * * (\$65,595.53) as and for commissions at the rate of 5% on \$1,311,910.60 of income collected by the said Paul Smart and Josiah Macy Willets, during the period from October 31, 1937 to October 15, 1940, of which sum \$24,958.08 was paid to Paul Smart and \$24,958.08 was paid to Josiah Macy Willets, on February 3, 1940, as shown in Schedule L of said account, and the balance of * * * (\$15,679.37) shall be paid to the said Paul

Smart and Gladys B. Willets, administratrix as aforesaid, by Paul Smart and Fidelity Union Trust Company out of the forgoing balance of income;

It is further ORDERED that there be allowed to Paul Smart and Fidelity Union Trust Company, trustees, the sum of * * * (\$12,089.62) as and for their commissions at the rate of 5% on \$241,792.45 of income collected by them during the period from October 15, 1940 until April 30, 1941, said allowance to be paid by the said Paul Smart and the Fidelity Union Trust Company out of the foregoing balance of income.

Pursuant to the two above-mentioned decrees, taxpayer received the following sums on the dates specified (R. 15):

December 28, 1937-----	\$29,418.32
February 8, 1940-----	24,958.08
December 29, 1941-----	87,082.43

In his tax return for the calendar year 1941 the taxpayer apportioned his commissions received on principal in that year (\$73,197.93 of the \$87,082.43) over the years 1934 through 1939, relying upon Section 107 of the Internal Revenue Code, as amended by Section 139 of the Revenue Act of 1942. (R. 16-17.)

The Commissioner determined that the taxpayer was not entitled to the relief provided by Section 107 (R. 18) and his determination was sustained by the Tax Court (R. 18-23) which concluded that taxpayer's principal commissions must be added to prior income commissions in computing "total

compensation for personal services"; as a result taxpayer was determined to have received less than 75 percent of that compensation in 1941 as the statute required. The Circuit Court of Appeals, being unable to find any indication in New Jersey law that income and principal commissions were awarded upon the basis of a distinct separation of services, affirmed the Tax Court. (R. 81-85.)

ARGUMENT

The decision of the Circuit Court of Appeals in this case is correct. That court did not fail to accord proper respect to state law, and no substantial question of importance is here presented.

Section 107 of the Internal Revenue Code (Appendix, *infra*) may be availed of only if 75 percent of "the total compensation for personal services" is received in the taxable year. In computing the "total compensation" for taxpayer's services the Tax Court and the Circuit Court of Appeals correctly took into account the commissions awarded with respect to income as well as the commissions awarded with respect to principal. Taxpayer's services as trustee cannot, as a practical matter, be separated into services rendered to income and services rendered to principal. The services of a trustee at the same time protect and improve the principal and protect and increase the income. Even though commissions are divided into income and principal commissions, this division, as the Circuit Court of Appeals ex-

plained, is an administrative device by which the cost is allocated between the income beneficiary and remainderman "either by some rule of thumb, statutory or judge-made, or according to the supposed benefit, or in some other of the ways which courts are accustomed to measure the incommensurable." However, in making this division "the court does not even impliedly try to separate the services into those which have benefited the income and those which have benefited the principal * * *." (R. 83.)

Taxpayer argues that a division of the cost indicates that the services are also separated, and that under New Jersey law the services are actually separately evaluated and compensated. He points to the terms of the New Jersey court's award and to the New Jersey statute which provides for rates of commissions payable out of principal and income, Revised Statutes of New Jersey (Cum. Supp.), Sections 3:11-1 and 3:11-2 (Appendix, *infra*), which he contends were ignored by the court below. The Circuit Court of Appeals did not disregard New Jersey law; instead it carefully considered the applicable New Jersey decisions and interpreted them to mean that principal and income commissions are correlatives in New Jersey. It found no basis for an assumption that New Jersey courts award income and principal commissions based upon a corresponding separation of services. In spite of the separate rates pro-

vided for income and principal commissions, the New Jersey statute merely establishes "standards of compensation." *In re Fidelity Union Title & Mortg. Guaranty Co.*, 136 N. J. Eq. 294. The New Jersey courts, in awarding principal commissions, do not look solely to the value of the services to principal, but instead appear to weigh the total services against commissions already awarded from both income and principal. *Van Houten v. Van Houten*, 45 N. J. Eq. 796; *Marsh v. Marsh*, 82 N. J. Eq. 176; *In re Fidelity Union Title & Mortg. Guaranty Co.*, *supra*. The cases relied upon by petitioner (Br. 14-15) do not appear to be contra or to establish that a New Jersey trustee's services are strictly separated into services to income and services to principal and that they are separately compensated.

This case presents no question of substantial importance inasmuch as the decision, which is based upon an interpretation of New Jersey law, can have application only to New Jersey trustees. For this reason, even if the opinion of the Circuit Court of Appeals in *Civiletti v. Commissioner*, No. 913, also pending on petition for a writ of certiorari in this Court, may be read to mean that a New York trustee's services are separately evaluated and compensated, there is no contradiction in the court's rationale, for the *Civiletti* case involves New York statutes and New York law.

CONCLUSION

The decision is correct. The Circuit Court of Appeals considered and grounded its conclusion on the applicable law. No question of substantial importance is presented to require review by this Court.

Respectfully submitted,

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MARCH 1946.